

STATEMENT OF POLICY
Zero Coupon Bond Promotions

Several West Virginia merchants have recently expressed to the Securities Division, (The "Division"), their interest in promotions involving the offer of "Zero coupon" bonds to consumers as inducements for the purchase of goods or property.

"Zero coupon" bonds, (The "Bonds"), are so named because there are no (zero) semi-annual interest coupon payments, as there are with par bonds. The Bonds are automatically locked-in at a specified rate to achieve the stated yield. The Bonds are deeply discounted and can be purchased for a fraction of their face value at maturity.

The Bonds, backed by the United States Treasury, are subject to yearly federal income taxes even though no semi-annual interest payments are received by the bondholder. Municipal Bonds are not subject to annual federal income tax prior to maturity although all Bonds sold prior to maturity are subject to federal income tax, even municipal bonds.

A typical Bond promotion states that a merchant will give a customer "free", a Bond with a face value equal to the value of the merchandise purchased (over a certain minimum amount), thereby returning to the customer what was paid for the merchandise. The promotion does not disclose that the person receiving The Bond will be responsible for taxes on the imputed interest even though that person will not be receiving payments of interest. Also not disclosed is that the market for Bonds is extremely susceptible to shifts in interest rates and therefore highly volatile. The disclosure matters can create serious problems for the customer and expose the merchant to unexpected legal liability in connection with the distribution of the Bonds. A merchant also runs the risk that he will be regarded as a broker-dealer within the meaning of the West Virginia Securities Act, (The "Act").

That Law regulated the securities business in West Virginia and defines a "broker-dealer", in part, as:

....Any person engaged in the business of effecting transactions in securities for the account of others or for his own account.

Section 32-4-401(J)(3) of the Act states in the definition of "sale" or "sell" that:

....Any security given or delivered with, or as a bonus on account of, any purchase of securities or any other thing is considered to constitute part of the subject of the purchase and to have been offered and sold for value.

The Division considers that a transfer of a Bond in these promotions is a "sale" of the Bond, under That Act, regardless of whether the transfer is characterized as "free" or a "bonus" or by words to that effect. Since the Division further regards a person who sells Bonds through such promotions to be engaged in the business of being a broker-dealer, any merchant offering such a Bond promotion would be required to be registered as a broker-dealer under The Act. Section 32-2-201(a) of the Act states:

It is unlawful for any person to transact business in this state as a broker-dealer....unless he is registered....

A person who acts as an unregistered broker-dealer in violation of Section 32-2-201(a) is subject to administrative, civil and criminal penalties. The Division, however, to be engaged in the business of being a broker-dealer and thus not required to be registered as such under The Act so long as the Bond promotion the merchant offers meets the following requirements:

1. Any advertising material used in the promotion must clearly state:
 - a. The present market value of the Bond;
 - b. The maturity date of the Bond,
 - c. The value of the Bond at maturity.

The disclosure for items a. and b. must be equal in prominence to that given to item c. In addition, any advertising material must also provide that:

d. No use is made of the term "free" in describing the promotion, although language such as "included with purchase" is permissible.

e. Make adequate disclosure that a person receiving a security in the promotion may be responsible for accrued interest tax liability.

f. Adequate disclosure is made that the market for Bonds is highly volatile, which may cause liquidity problems for Bond owners seeking to sell their Bonds.

2. The merchant must give each customer who takes advantage of the promotion the cash equivalent of the current market value of the Bond and advise the customer that the customer is free to retain the cash for his or her own personal use.

3. If the customer elects to purchase a Bond, he or she must do so through a broker-dealer which is registered under The Act.

4. Any Bond so purchased must either be registered under The Act or exempt from such registration.

POLICY STATEMENT
WEST VIRGINIA SECURITIES DIVISION
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